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C O N F I D E N T I A L SECTION 01 OF 02 CARACAS 001711

SIPDIS

ENERGY FOR CDAY AND ALOCKWOOD
HQ SOUTHCOM ALSO FOR POLAD
TREASURY FOR RJARPE
NSC FOR JSHRIER
COMMERCE FOR 4431/MAC/WH/JLAO

E.O. 12958: DECL: 12/12/2018
TAGS: EPET EINV VE
SUBJECT: PDVSA FORCING JOINT VENTURES TO CUT BACK ON
PRODUCTION

REF: A. CARACAS 559
¶B. CARACAS 1540

Classified By: Economic Counselor Darnall Steuart for reasons 1.4 (b)
and (d).

¶1. (C) Summary: Shell Venezuela executives said PDVSA had mandated a 25 percent production cut in its joint venture with PDVSA as a result of OPEC-mandated production cuts; other joint ventures were also subject to cuts. They confirmed Shell's purchase of the data pack for the Carabobo blocks in the Faja and press reports of the addition of a third upgrader-block combination to the project that was not reflected in the current data pack. End summary.

Cuts in the Joint Ventures

¶2. (C) Shell Venezuela President Luis Prado (strictly protect throughout) told Econoffs December 11 that PDVSA had recently forced Petroregional del Lago, Shell's joint venture (JV) with PDVSA, to cut production by 25 percent in response to OPEC-mandated production cuts. (Note: Petroregional is a JV in which PDVSA is the majority shareholder; it was formed after the Government of the Bolivarian Republic of Venezuela (GBRV) forced the "migration" of operating service agreements (OSAs) to PDVSA-controlled JVs in 2006. According to PDVSA, JVs formed from OSAs produced an average of 330,000 barrels per day (b/d) in the first half of 2008. End note.) Prado said that, in response to a push to increaseQroduction mandated by PDVSA at the end of 2007, Shell had worked hard to raise Petroregional's production from 32,000 b/d to a peak of 44,000 b/d. It was now forced to accept a cut from an average of roughly 42,000 b/d to 30,000 b/d. He added that other JVs that were former OSAs were also being forced to cut production, noting the JVs were clearly taking the brunt of OPEC-related production cuts.

¶3. (C) Prado, who prior to April 2008 was Shell Venezuela's Maracaibo-based VP for Exploration and Production, related the difficulties of the conversion from OSA to joint venture, including an initial hostility on PDVSA's part and PDVSA's initial insistence that its policies be immediately implemented and employees be immediately put on its pay scale (which would have required an immediate pay cut of 40 percent on average for migrating Shell employees). He characterized the current operating environment for Petroregional as

challenging but, from Shell's perspective, acceptable. PDVSA allowed Shell employees to occupy key management positions such as operations, finance, health and safety, and development. While Petroregional's payments to Shell were not being made on time, they were being made. Prado noted Petroregional had negotiated the necessary permissions and agreements to expand into an adjacent block to the north (essentially a continuation of the same reservoir) through which it could significantly expand production, but that given a series of PDVSA and GBRV conditions, beginning with the windfall profits tax (ref A), Petroregional had decided the financials did not merit an expansion.

The Carabobo Project

¶4. (C) Prado confirmed Shell had purchased the data pack for the Carabobo blocks and was attracted by the prospect of developing production in the Faja. Subsequent to the initial bid round announcement (ref B), PDVSA expanded the project from two to three upgrader-block combinations, with the additional upgrader-block combination encompassing three blocks. Prado and his colleagues noted information on the additional blocks was not available in the initial data pack nor included in the data room open for the month of December. A second data pack was being prepared, and the overall bid timetable would have to be adjusted accordingly. Prado said PDVSA had told interested companies that the winning consortia would have control over their respective projects in the construction phase and would be given key management positions in the operational phase. He estimated the actual

costs of constructing and developing a given upgrader-production block combination would be between USD 15 and 30 billion, far higher than PDVSA estimates.

¶5. (C) Prado said Shell was not looking at the moment to participate in natural gas development in Venezuela, having been twice rebuffed in its attempts. In addition to the Carabobo project and the potential for expanding Petroregional to the north, Shell was also watching the process of consolidation of several smaller joint ventures in Lake Maracaibo. (Note: Per Prado, joint ventures subject to consolidation were Petroindependiente (with Chevron), Lagopetrol (with Hocol), and Petrowarao (Perenco). He said CNPC, which had also been approached by PDVSA, had refused to participate. End note.)

Comment

¶6. (C) We had previously heard from contacts at Chevron that PDVSA had ordered OPEC quota cuts from their two JVs, but Chevron executives were not sure PDVSA would follow through. To the extent that Shell's can be generalized, it looks like PDVSA is indeed following through and is serious on cutting production, at least to some extent, per OPEC commitments. Given the GBRV's urgent need for cash, it makes sense PDVSA would mandate cuts at the JVs rather than PDVSA-only operations. End comment.
CAULFIELD